KTS CAPITAL MANAGEMENT

INVESTMENT HORIZON 2021

The 22nd of December 2020

EXECUTIVE SUMMARY

- 2020 set the start of a new long term fiscal paradigm.
- Direct lending and factoring have become even more attractive. Low volatility uncorrelated to traditional asset classes gives stability to the portfolio.
- Emerging Markets are the most attractive asset class.
- Gold and Bitcoin are value storing.
- The transition phase of today's financial system is based on a very fragile equilibrium, therefore, KTS will keep focusing on diversification by investing in different strategies, rather than asset classes.

2020 was not only minted from an unprecedented pandemic, but also from a surprisingly fast and massive monetary response to Covid-19 from central banks and governments.

KTS's strategy had already been to increase downside protection at the new market's highs during December 2019. That was in addition to employing a diversified selection of strategies, in the place of asset classes, and not leveraging the portfolio. All, of which, helped to limit the drawdown during the dramatic market correction in March 2020, when the main market indexes experienced a negative performance up to -40% from the highs. We were able, therefore, to increase equity exposure with excellent timing because we were not pressured into panic selling or being forced to liquidate leveraged portfolios, as many competitors and private banks had to do.

The Optima Dynamic FoF solidified its position in the top 4% percentile worldwide and should end the year with a +13% performance, meanwhile most of its peers are still expecting a negative to slightly positive performance year to date for balanced mandates.

Our alternative fixed income (Factoring) part of the portfolio helped to stabilize the portfolio, especially during sharp market corrections. The strategy produced a strong performance of + 4% with extremely low volatility. The performance of the strategy was actually even better than +4% because yields on the cash account and most investment grade bonds are in negative territory!

We would like to state again, that strong discipline, rational behavior and avoiding panic was possible only because of **years of investment policy in strategies with attractive risk/reward profiles** and not in products, which were meant to increase the profitability of the asset manager!

It is also important to notice the fall of some investor "legends" like Bridgewater or Renaissance Technology's funds and others, which experienced dramatic negative performances during 2020.

During the year 2020 we can affirm that governments effectively applied the much debated Modern Monetary Theory (MMT) to support their citizens; such an effort is going to dramatically change the future investment environment, as well as consumer behavior.

Finally, we are all entering a new era. One where economic theory will have to be re-written; yet without anybody actually knowing for certain the outcome!

We can also affirm, that **2020 is the beginning of a new form of global capitalism, which may lead to a temporary suspension of "laissez-faire" capitalism** and that the Covid-19 crisis was just an accelerator of pre-existing trends.

The combination of QE, stimulus packages and "helicopter money" now allows policymakers to direct resource allocation.

During the FED's speech on the 27th of August 2020 for the annual Jackson Hole Summit, Federal Reserve Chairman Jerome Powell set a new bar for the accommodative monetary policy, **cementing interest rates by 0% basically forever**, but targeting higher inflation during the years to come.

For the investor community this will mean **negative real rates going forward**, therefore, only real assets can profit in such scenario. The investor community started modeling a negative real rate scenario and factored in the valuation of various asset classes

The resulting outcome suggested a further **100% or more upside potential for growth equity, and further upside potential for gold / goldminers and real estate.**

Most market participants still do not realize that the current situation is not comparable to the "tech bubble" of year 2000. Mostly because of the level of interest rates (the risk free benchmark) and the risk of higher interest rates in case of stronger economic growth.

Back in March 2000, the Nasdaq 100 Index traded at 53x earnings vs 25x today (but already much lower at 21x for 2021) and P/FCF valuations were even more extreme, with 118x vs 31x today (lowest level ever).

Based on the excess liquidity model, P/E's should actually triple from today's levels.

Plain vanilla bonds are no longer attractive, except for emerging market high yield bonds, Chinese and Japanese bonds. Bond's P/E are 6 times higher than equity and taking into consideration that the 12m forward is going to be flat, bonds are even more expensive.

In the fixed income space, **direct lending and factoring became even more attractive**. Central banks set guarantees for lending to mutual funds and banks in order to support business suffering from the covid-19 pandemic. The sector is also experiencing a massive improvement in the optimization of default ratios, thanks to digitalization and FinTech, where machine learning helps to analyze lenders data. Ant Group's planned IPO is an example of such. For this reason, we remain invested in our factoring investment vehicles, which are helping give stability to the portfolio, reducing volatility and are mostly uncorrelated to traditional asset classes.

Finally, market participants are no longer focused on high government indebtedness, because **lower interest rates via new issues of Government bonds are translated into lower debt costs in percentage of GDP**. Higher inflation, combined with higher economic growth from 2021 following an expected successful vaccination, is going to automatically reduce such a high level of indebtedness. In any case, central banks still have "plenty of room" to "fill in" the gap of falling demand for unattractively priced Government bonds.

This new environment is massively influencing consumer behavior, especially of new generations, which we should not forget, are soon going to inherit massive wealth (according to "The Economist" baby-boomers own 63% of the total USD 9.1trn wealth and the silent generation 20%).

In the long run, the value of money is going to devalue dramatically, therefore, younger generations, contrarily to our ancestors, will have to spend money instead of saving it.

The main dilemma in the long run will be the falling purchasing power of pension plans. However, the increased value of inheritance to younger generations is going to partly compensate this gap. Analyzing the figures, we think, this is the most probable outcome.

Whilst most of traditional sectors suffered during the early part of year 2020, the travel industry and the energy sector, experienced the worst downturn in memory, something unprecedented and much more severe than the markets response to the horrors of 9/11 or SARS in 2002. On the contrary, digitalization, biotech and "clean energy" experienced impressive outperformances.

2020 and covid-19 are accelerating the digitalization and sustainability processes. Which, as KTS has argued for some time now, are going to stay with us for decades. But it is very important to be invested with experts in the chosen sectors, because passive investment vehicles invested in securities with valuations at bubble

levels. Comparable with similar historical market exuberances like "German new market" or the "tech bubble" of year 2000, and also the German solar bubble or Canadian cannabis boom.
ETF`s like TAN US experienced 2 bln USD inflows in a period of a few months, therefore, **single stocks in their sector rallied massively because of such huge inflows, but valuations were not supported by fundamentals.**

The biggest risk we see for investments during 2021, is a correction in momentum stocks, especially in the green and sustainable segments and in some "stay at home" stocks. In addition, following the Justice Department filing of an antitrust lawsuit against Google for monopoly (the last of such filings was against Microsoft 20 years ago) and, more recently Facebook, we see the risk of more political pressure, not only for monopoly, but also for tax issues and data manipulations against many in the FAANGMT universe.
In addition, we want to mention a few scandals during the year 2020 like Nikola, Luckin Coffee, Wirecard, etc. which shows, once again, that even in such an over regulated environment, fraud risk is still very high. Therefore, KTS will continue to focus on joint ventures with external experts and partners to reduce the risk of investing in fraudulent offerings.

On the other hand, we are convinced that some laggards of 2020, like the travel, energy industries and value stocks in general, could start rebounding in the hope of a normalization process due to the launch of a successful vaccination. Markets are, typically, going to anticipate the event some months in advance.

People will want to travel as soon as restrictions are abolished. This, combined with the fact that global savings spiked during 2020, suggests we are going to experience a tremendous increase in travel and consumption in general; but especially spending in the entertainment sector.
KTS is analyzing intensively the opportunities available by finding solid companies and active asset managers in the space. For example, we added a new position in the well-known Swiss asset manager Classic Global Value Fund, which has a proven long term track record. We also added several long/short managers in the "clean energy" space. Sector rotation and sector technical analysis will also offer attractive investment opportunities. Tactically, we continued to pursue an opportunistic approach by selling volatility.

2020 was a great year for such a strategy, not only because markets were volatile, but also because volatility levels were much higher than in the past years. In fact, volatility levels stayed over 20% compared to 10% in the past
Anticipating the increase in negative real interest rates, it is now clear to all market participants that **the gold price is strongly correlated to negative rates (R2 0.95) and not so much to the USD.**

Therefore, we expect goldminers to continue to perform well during 2021.

The fundamentals of the goldminers never looked so healthy, having cut costs and repaired their balance sheets. Margin expansion should support an increase in the amount paid out by way of dividend's. We would like also to mention that Warren Buffett purchased gold and sold most of his bank holdings back in August 2020. No doubt preferring gold as a more effective way to protect his investors from what many are now fearful of an emerging fiat monetary system.
We can see this already, the dramatic scenes in the Grand Bazaar in Istanbul where Turkish citizens now pay with gold, having experienced a 25% devaluation of the Turkish lira whilst living in a high inflation environment or Russia increasing value of its FX reserves by almost 30%, despite the collapse of the oil price. These are practical examples of **gold as a reliable store of value.**

Bitcoin is, in our opinion, the gold and store of value for younger generations. According to Charles Schwab, the Grayscale Bitcoin Trust is the 5th largest holding in millennials retirement accounts. The recent Bitcoin rally was, principally, supported by institutions. They cannot avoid gradually directing a small part of their global asset allocation towards an asset class shown to be uncorrelated to traditional assets. Apparently, the majority of institutional investors are still not invested in the crypto currencies, but are intending to do so.
Commodities are going to profit on multiple levels going forward. The price of commodities is also correlated to inflation and negative interest rates. In addition, massive stimulus packages to invest in infrastructure and clean

energy are going to increase, dramatically, the demand for industrial commodities. Roofing ventilation systems require zinc, LED lighting uses copper, gallium and indium, wiring upgrades require copper, solar panels utilize copper and silver, and heat pumps need nickel and copper. Therefore, we will stay invested in the best-in-class Fund Bakersteel Electrum (mix between gold and rare metals).

Emerging markets, as a percentage of global assets under management, are close to all-time lows, but analyzing the **secular efficient frontier; EMEA and Asia equities are the most attractive asset classes, followed by Swiss Equities and EM debt in both local and USD currency.** Given that the USD is supported by weak fundamentals and adding in the demographic and fundamental attractiveness of EM regions, persuades us that, going forward, emerging markets are considerably more attractive than developed markets.

40% of the world's population lives in the Valeriepieris area, which, in turn, represents 70% of worldwide GDP growth!

An excellent example is the **Vietnamese market**, which experienced the best single country GDP growth during 2020 and also one of the best stock market performances; we will continue to stay overweight during 2021, because the Vietnamese market is still underpriced and is profiting from the further outsourcing of Chinese manufacturing.

The U.S. election outcome was actually the most positive outcome for equity markets. The economy is going to receive a much-needed liquidity injection to overcome the Covid19 crisis and (eventually) generate the hoped-for pickup in inflation. The Biden administration, even with a Republican Senate, will be able to launch planned stimulus packages in education, clean energy, infrastructure and health & caregiving for a total of USD 5trn over the next 5 years, generating 3.5% to 4.2% GDP growth. They will not, however, have the political wherewithal to increase taxes or to regulate the financial and technology giants.

The US deficit is going to explode, so we also agree with the general consensus that over time the USD is going to depreciate further.

During 2020, China experienced an impressive recovery. Not only in economic activity, but also travel movements, which are back at pre-crisis levels!

Needless to say, most of the growth worldwide is going to come from the Chinese economy The weighting of China in the emerging market indexes has increased from an insignificant percentage in year 2000 to 42% in the year 2020. China is also closing the huge gap in IT innovation and R&D spending and has stronger financial capability to investment vs. the rest of the world.

The world underestimates that China has already displaced the U.S. to become the largest economy in the world, on PPE metrics (purchasing power parity) with USD 24.2 trillion vs. USD 20.8. China's newfound economic supremacy came about in spite of trade tensions, trade wars and a global recession.

By 2025, the value of all goods and services produced in China will likely exceed the comparative US value.

China is also stepping up its military spending and after the WWII duopoly of Russia/US China is now in the ascension to expand beyond the critical tipping point.

We are probably going to experience a rupture to global supply chains and the re-onshoring of production. As mentioned, we believe that the Vietnamese market is going to profit the most of such an event.

Also, the de-dollarization trend will gather momentum, therefore, we will stay invested in gold and bitcoin. We believe that bitcoin will not only be a store of value, but also a possible substitute to the worlds dependency on the global Swift payment system, which the U.S. clearly abused to blackmail many countries, banks and financial institutions by imposing sanctions worldwide.

Europe should also profit from a stronger economic rebound during 2021, taking into consideration that their governments will also inject massive stimulus packages, positively surprising market participants. Germany provided the most positive surprise, having been too conservative for too long, by launching the most important stimulus package in Europe.

Even if KTS is convinced by the strong fundamentals for global real assets, we are also aware that the transition phase of today's financial system is based on a very fragile equilibrium, due to the artificial flows of global central banks, but even more due to passive investment vehicles and their dangerous concentration in selected major blue chips.

Therefore, we are going to maintain our focus on strategy diversification, particularly on those strategies which help to limit the downside risk. We are keeping our positions in long volatility funds (ABR and Z22) and also in our flexible dynamic best in class funds, which have enough flexibility to adjust their asset allocation to special events (Flossbach Multiple opportunities, MAN Trendrisk, Alkeon, etc). To which, we added the fund from www.fasanara.com, which has an investment process based on the "chaos theory" model; attempting to recognize early stages of disequilibrium in the system, which could lead to market corrections.

With the combination of the different models and strategies, KTS will also try to identify possible early signals of market imbalances and consequently increase or decrease hedges in asset allocations.

We fully agree with the manager of Fasanara, about the definition of today's markets as Fugazi markets, based on only 2 factors: chaos and futility. Resulting in the impossibility to diversify with traditional assets classes, or to allocate capital based on merit and fundamentals.

Markets are driven by flows and momentum chasing by retail investors. Basically, we are entering the last phase of the bull market, which in behavioral finance terminology is defined as an "illusion of knowledge" trap.

Arguments, which KTS has held for some time now.

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